Wipe out rentiers with cheap money

Cautious savers no longer serve a useful economic purpose

High-income economies have had ultra-cheap money for more than five years. Japan has lived with it for almost 20. This has been policy makers’ principal response to the crises they have confronted. Inevitably, a policy of cheap money is controversial. Nonetheless, as Japan’s experience shows, the predicament may last a long time.

The highest interest rate charged by any of the four most important central banks in the high-income economies is 0.5 per cent at the Bank of England. Never before this period had the rate been below 2 per cent. In the US, the eurozone and the UK, the central bank’s balance sheet is now close to a quarter of gross domestic product. In Japan, it is already close to half, and rising. True, the Federal Reserve is tapering its programme of asset purchases, and there is talk that the BoE will soon tighten policy. Yet in the eurozone and Japan the question is whether further easing might be needed.

These unprecedented policies are needed because of the chronic deficiency of global aggregate demand. Before the wave of post-2007 crises hit the world economy, this deficiency was met by unsustainable credit booms in a number of economies. After the crises, it led to large fiscal deficits and a desperate attempt by central banks to stabilise private balance sheets, mend broken credit markets, raise asset prices and ultimately reignite credit growth.

These policies have succeeded in lowering the cost of borrowing. This has made it easier to bear both the huge quantities of private debt inherited from before the crisis, and the public debt that has been accumulated in its aftermath. A report from the International Monetary Fund published in October 2013 concluded that the bond purchase programmes from November 2008 lowered US 10-year bond yields by between 90 and 200 basis points. In the UK, bond-buying that began in 2008 lowered them by between 45 and 160 basis points. In Japan, similar interventions from October 2010 lowered rates by about 30 basis points, although Japanese yields started from a lower level.

Lower interest rates have also had a significant effect on the distribution of income. A study by McKinsey Global Institute published at the end of last year shows large shifts in income from net creditors to net debtors. In general, governments and non-financial corporations have gained. Insurance companies, pensions providers and households have been among the losers.

Banks are in an intermediate position. US banks have gained because their interest margins have risen. Eurozone banks have lost because their interest margins have been squeezed. UK banks have also suffered small losses. (See charts.)

Some of the details are significant. Governments are winners not only because the interest rates they pay are lower than before the crisis, but because quantitative easing has monetised a substantial portion of government long-term debt. Thus, in the case of the US, the Federal Reserve transferred $145bn in gains from quantitative easing to the government between 2007 and 2012. This is in addition to the $900bn the government saved over the same period through lower interest payments. In the UK, quantitative easing produced gains of $50bn for the exchequer in addition to $120bn in interest savings.

Again, in the case of the US, sharply lower interest rates accounted for 20 per cent of the growth of profits of non-financial corporations between 2007 and 2012. But there have been adverse effects on pension funds that must honour the promises they have made to members in defined-benefit schemes, and on insurance companies – particularly those that offered guaranteed nominal returns.
In the case of pension funds, reduced long-term yields are particularly unwelcome because they both lower returns and raise the present value of future liabilities. Many life insurers might be forced out of business if these rates persist. This is a crisis on a long fuse.

For households, the distributional consequences of ultra-low interest rates are more important than their aggregate effects. In the US, households with heads aged 35 to 44 are gainers from lower interest rates, while older households are losers. On average, the younger group gained $1,700 in annual net interest, while those over 75 lost $2,700. Above all, the richest 10 per cent of Americans own about 90 per cent of all financial assets. Thus the main losers are relatively prosperous people who depend on interest income. At the same time, such people have also gained from huge rises in bond prices and strong equity markets, although McKinsey argues that low interest rates are not the most important factor behind equity gains.

This policy, however unpopular with some, is better than the available alternatives. Keynes even had a phrase for it – the “euthanasia of the rentier”. In a world of abundant savings, the available returns ought to be low; this is a consequence of market forces to which central banks are responding.

At present the world’s high propensity to save is not matched by a desire to invest. This is why fiscal deficits remain large and interest rates ultra-low. At the margin, additional savings are now useless. Returns are being pushed even lower by the fact that central banks are seeking to prevent the bloated balance sheets created before the crisis from collapsing in an episode of mass insolvency.

There is, however, a puzzle. Why is private investment not stronger, given that the non-financial corporate sector is apparently so profitable?

Perverse managerial incentives are one explanation. The weakness of the financial sector is another. Then there is the vicious circle from weak demand, to sluggish investment, and back to weak demand. And to many, it seems sensible to postpone investment until the world is more predictable.

Low interest rates are certainly unpopular, particularly with cautious rentiers. But cautious rentiers no longer serve a useful economic purpose. What is needed instead are genuinely risk-taking investors. In their absence, governments need to use their balance sheets to build productive assets. There is little sign that they will. If so, central banks will be driven towards cheap money. Get used to it: this will endure.

martin.wolf@ft.com

Letter in response to this column:

Dominance of cheap money and a skewed view of equity / From Mr Andrew McNally

Robert Looney

FrankM

So the fact that I’ve worked (quite) hard for twenty years, made good money and saved it instead of taken on massive amounts of leverage should now be punished by wiping me out because I have ‘no useful economic purpose’. Moral hazard, anyone?

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June 2, 2014

FrankM

So the fact that I’ve worked (quite) hard for twenty years, made good money and saved it instead of taken on massive amounts of leverage should now be punished by wiping me out because I have ‘no useful economic purpose’. Moral hazard, anyone?

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http://www.ft.com/intl/cms/s/0/d442112e-d161-11e3-bdbb-00144feabdc0.html
"These unprecedented policies are needed because of the chronic deficiency of global aggregate demand."

Wrong. These unprecedented policies are needed by the bankers and politicians who maintain their positions of power and wealth via artificially high prices. In other words, there is one price structure (higher) which allows the current debt-laden and corrupt system (and the puppetmasters who run it) to remain in place. There is another price structure (lower) which allows the middle and lower classes to benefit from ongoing productivity improvements. There is only a “deficiency” of demand at the crazy price levels promulgated by the keepers of the status quo. The only thing “chronic” is the inability of TPTB to see the simple fact that the over-levered system as it exists today cannot last. And postponing the day of reckoning (like Japan) only increases the ultimate pain.

Richard Cranium

Is this article a joke?

May 16, 2014

Gian Marco Mensi

After reading this article I am seriously questioning the rationale behind my FT subscription.

May 13, 2014

Serf8973521

@Ian Campbell:

Please allow me to contribute to the reading list:


Astute words in Stockholm 40 years ago.

May 9, 2014

Kaleberg

Our problem is still low taxes and low wages. C and G are too small, so there isn’t enough demand to drive I. In the 1980s, households made it through when women entered the workforce. Then came a market bubble followed by a real estate bubble where the only thing fueling the economy was cheap loans. We’ve had 30 years of anti-business policies. Now, we have a new generation entering a stagnant economy miles deep in debt. We used to pay for education out of income taxes. The more you made, the more you paid. America needs to rebuild its consumer base.

May 8, 2014

lostinsweden

The lack of demand is because the middle class are generally struggling to make ends meet. In addition, the disparity in income between the employee on the shop floor and management has increased perversely the past 30 years. Everyone likes to be able to spend money on non-essential items, but few today have the opportunity.

May 8, 2014

sensiblebloke

"Perhaps it helps to explain why there is a lack of demand"

The lack of demand is natural end game of loose monetary policy - asset prices inflate and raise key components of the cost of living (principally housing) hence people’s disposable income falls.

May 8, 2014

sensiblebloke

Since when does saver == rentier ?.
Larchmont

Bit of a meander. Bottom line MW believes that QE2 spurs risk taking. The flip of this is that it drives riskier transactions which takes us back to where we started pre-crisis. The good side of a recession is that it brings fear back into the equation. That fear hasn’t gone away but is being perversely held down by QE2. Investors are uneasily aware of the day of reckoning but with no where else to go are taking on risk. The fact that the equity markets are at all time highs is a sign of the instability QE2 creates.

Japan is so different because it went into its crisis 30 years ago with huge personal savings and those have stayed up. But little investment was produced by all the efforts of the Japanese to reflate. US and UK don’t have those savings to cover govt debt and that must make the whole QE2 exercise much riskier.

End of day QE2 borrows future growth. Keynesians argue it saves unnecessary loss as well but the jury is out on that (US is much more slash and start again economy and it doesn’t seem to suffer). So MW is hoping that somehow growth gets fast enough to overcome this. US is turning off the drip feed. Maybe growth will then improve when physical investments look better than playing stocks and alternatives.

Voltairesque

Don’t forget about helping those with ample assets. Cheap money also helps boost gini coefficients (i.e., greater inequality) as asset values balloon. So then what MW really meant to say is --> wipe out rentiers and the middle class while helping politicians and the ultra-wealthy. Good job MW, another populist tour de force.

Ian Campbell

A long read but to get some balance to what has been written by MW I recommend it for some sanity.


© MW You might learn something.

@daviddenton20

The creeping advance of secular stagnation will kill off the middle classes anyway so no need to worry about the Cautious Rentiers - http://getwd50.blogspot.co.uk/2014/05/believing-in-secular-stagnation.html

Ian Campbell

“Well, let’s see. Non-financial business has taken its debt from $11.0 trillion on the eve of the financial crisis 76 months ago to $13.6 trillion today, but this immense borrowing binge all went into financial engineering in the form of stock buybacks, LBOs and M&A deals. Actual “aggregate demand” for real plant and equipment outlays is still $70 billion or 5% below it 2007 peak. So how can another month of ZIRP accomplish what the first 67 months evidently haven’t?”

From someone with a bit of common sense - David Stockman in the US - unlike the originator of the words above. Definition of stupidity: to repeat actions that have previously failed. Exactly what MW is advocating here, financially killing those who want to work hard and earn their money. As many comments here have said one of the devils in the current details are the ridiculous incentives for senior execs to do otherwise, and OPM - other peoples money that is made available to them for free.

Hill

It is the intervention by the central banks and the obvious manipulation of the markets that is preventing the true risk-taking investors from entering the markets. Presently, the free markets are truly not free.
RiskAdjustedReturn

@aegian "That's what's happening on a terrifyingly large scale."

Exactly.

Yet somehow banks and bank bondholders are not considered to be "rentiers", even though they're given our money at negative real rates, borrowing at .5% and loaning it back to us at 4-8%.

I suppose you could argue that they still take a smidgen of risk, but it's pretty damned small, considering that they know that if they ever have any real trouble, public money will be deployed to make them whole.

So why isn't it necessary that the .01% rentiers at banks be "wiped out"?

Only those of us with savings accounts need to be wiped out, apparently.

aegian

"Sorry about that, but you've been classified as a rentier who must be "wiped out". Painful, I know, but it's important that your savings be funneled to global banks and corporations."

That's what's happening on a terrifyingly large scale.

RiskAdjustedReturn

"I don't understand. More than half the world is poor. This is a huge waste of human potential. Apart from being immoral. The investment potential should be huge. Shouldn't we be looking at how to make that happen?"

I think we are. After all, there's no requirement that all that the (our) free money being loaned (given) to banks and corporations be invested in our own countries.

"Are we not, in the West, approaching a situation when every teenager has a car and every household a wide scree TV?"

True, although I believe that's due to their parents' incomes. Where I live, young people have eschewed cars and TVs and often even computers in favor of smart phones (on the family plan), but they don't appear to be on track to provide very well for their own future children, so the next generation of teenagers may need to pay their own phone bills.

"OK, I'll spend all my money now, then when I retire I'll demand a pension from the state."

Sorry about that, but you've been classified as a rentier who must be "wiped out". Painful, I know, but it's important that your savings be funneled to global banks and corporations.

Hank Krouwel

Ca: Yes I know. I was thinking about Western economies, the subject I think Mr. Wolf was addressing. It would, in my view, be a very good thing if workers in the Far East got themselves a decently defiant Union structure and thereby ensured the profits of production were more evenly distributed, hopefully more towards those who create real demand, but that's a different story and not expected to happen soon. Meantime the West is in the bind Mr. Wolf describes.

Ca

Hans - please. Most of the world doesn't live in the west; most teenagers in the world don't own a care; most families in the world don't own a widescreen TV.
Hank Krouwel  May 8, 2014

I'm just musing here but didn't Keynes also consider, quite seriously, the possibility that there could arise a 'surfeit of goods' should the general population become sufficiently well off to have satisfied all reasonable demands? Are we not, in the West, approaching a situation when every teenager has a car and every household a wide screen TV? Are we not also in a situation where industrial technology can provide a surfeit of good with a tiny workforce or, where not, people in a foreign state run economy can be employed on coolie wages in coolie conditions? It strikes me the great minds who like to comment might think about the implications. We are, I think, in need of a fresh look at all this. Keynes solution, just to upset you all, was greater State control of productive investment. Just like in China (and Germany).

skeptic01  May 8, 2014

The article doesn't actually say why wiping out cautious savers would be a good thing. The line of reasoning seems to be:
A. There's a mismatch between savings and investment
B. Therefore, market forces should generate low returns to savers
C. Therefore, savers don't morally deserve good returns
D. Therefore, central banks should intervene to ensure low returns to savers

Does C follow from B? And if B is true, then why is D necessary? One could just as easily reason as follows:

D. Central banks are intervening in the market to artificially lower returns to savers
B. Therefore, market forces if left to themselves would be generating higher returns
C. Therefore, savers morally deserve higher returns than they currently receive
D. Therefore, the rentiers should revolt and overthrow the central banks.

Gregor  May 8, 2014

It might be worth looking at the underlying demographics.

The most affected Eurozone economies (Italy, Greece, Spain etc.) have age structures similar to Japan. Similarly, Germany has low consumption (as individuals top up their pension pots). So the Eurozone monetary policy may well become similar to Japan's.

The question is what will happen to Eurozone property prices - John Dizard argued in these pages a few days ago ("Spanish property advice from the plague") that the Spanish property boom was an blip in the overall downward trend, which is dictated by a shrinking population. We can currently see the opposite in London and Zurich. Are they the new Tokyo? What role will interest rates play?

Adam Bartlett  May 7, 2014

@Nicki - one could view most of Wolf's career as looking into exactly that, and IMO it couldn't have been done with any more clarity or credibility. If you read 'Fixing Global Finance' for example, the recommendations are mainly pitched as ways to improve the health of the overall economy. But there are a few key sentences suggesting the world's poor would be among the chief beneficiaries from the ideal changes in investment flows.

With a few exceptions, neither the market nor government want to make the needed investments on the necessary scale, so ZIRP may currently be the only feasible way to forestall the fate of Midas.

Larry Lamar  May 7, 2014

"Cautious rentiers no longer serve a useful economic purpose"? OK, I'll spend all my money now, then when I retire I'll demand a pension from the state. That will not only lower the amount of useless savings, it'll help create economy-boosting jobs in the government administering the pension system. Win-win!

Nicki  May 7, 2014

http://www.ft.com/intl/cms/s/0/d442112e-d161-11e3-bdbb-00144feabdc0.html
I don't understand. More than half the world is poor. This is a huge waste of human potential. Apart from being immoral. The investment potential should be huge. Shouldn't we be looking at how to make that happen?

NuffZed

May 7, 2014

I give you a different perspective Mr. Wolf, based on conversations with my Japanese based colleagues (mainly local people, not ex-pats) who I see on a frequent basis. Many have not seen a nominal increase in their salary for some years, or very small increases, due to the zero-inflation / deflationary environment. But their purchasing power in real terms has risen considerably - they can buy more with what they have. Has deflation deferred their purchase intentions? Not as much as many macro-thinkers believe - people always want stuff, and certainly in Tokyo Bay area, they love to go out. Companies like I work for in the real economy are driven by volume to grow their bottom-line - meaning its in our corporate DNA to give people more choices on their discretionary spending intentions. In turn this means dropping our prices, and working backwards to our product design to secure its still at a good margin. Deflation is not as bad as people think if they look at their purchasing power. Money illusion is rife thx to the scare-mongering among economists who have not a clue how retailers work in the modern world.

bondtrader

May 7, 2014

Wow! Martin Wolf sounds like the babbling of a madman.

skeptic01

May 7, 2014

Does the cited McKinsey report take account of the rise in asset prices? That is, if a household with a mortgage is paying less in interest than 5 years ago, is that for equal sized mortgages or does it take account of the fact that you now need a bigger mortgage to purchase the same property?

Citymoose

May 7, 2014

Note, use of the term cautious rentiers. Those with capital who have stuck money into real estate or equities have done handsomely, Those will a cash deposit at the bank appallingly. Martin Wolf suggests this trend will endure. We have 21st century stagflation. A fall in commodity prices, a slack labour and goods market. Piles of money buying less and less each year, with 90% of the population getting poorer.

Englishman in Norway

May 7, 2014

@ Paul Munton’s Potimarron
"I noticed your comment; I thought it insulting to the writer."
I noticed your comment and find it insulting to democracy.

Is it that easy?

May 7, 2014

@macrostratedge

Excellent link.

Is it that easy?

May 7, 2014

Not an ounce of facts or rationale for the efficacy their policy from our money printers on here - just unexplained conundrums as to why it just isn't quite working out...

Mr Wolf at least effectively acknowledges this in this piece - he was wrong again.
Is it that easy?

As such a staunch advocate of cheap money, perhaps Mr Wolf may actually bless us with a comprehensive piece on the full implications of such a long term policy stance?

As his convictions grow stronger, perhaps now is the time to do something he has never done before?

Martin: It is truly striking that US economists and policymakers are so deaf to the dog that will not bark in the night. To wit, during the limp expansion since the GFC, we have historically high profit margins, historically low corporate bond yields, a strong surge in corporate debt...and no investment boom. WTF? You begin to lift the covers on the problem in your second to last paragraph. The incentive structures for corporate managers and institutional investors are all wrong. They emphasize ultra short term profits (mostly through financial engineering) and rent extraction. But no one wants to name the beast we unleashed over the past three decades. Here is some material that might help you name it and run with it:


Well this column ought to bring every crank pseudo, Austrian/Libertarian out of the woodwork.

So as I reach retirement and the State cannot afford to keep me in the manner with which I wish to be kept, I saved my money so that I could change from a net saver (cautious a little) to a net spender later.

Some thoughts, not all connected.

Perhaps investment is low as we move from a physical economy to a digital economy, from an economy where cars, white goods, etc lasted 5-7 years to one where cars last 15 years at least, where because we know we will live longer than our parents we save for that future.

Another factor that relates to return expectations: returns are looked at quarterly, companies are expected to raise profits and every quarter and dividends every year, no wonder that manufacturing investment has come from the Chinese, we would not be able to afford the cash flow nor the relatively low returns that is generated through that type of investment. Indeed in the UK without major subsidies or the Government shouldering the whole burden infrastructure investment with returns in the low single figures is ignored.

So would a command economy do any better? I do not think so, they choose often to ignore their customers: customer service is non-existent and product design and choice hardly meets customers' needs.

Maybe to raise people’s expectations of investment returns interest rates should rise and maybe the risk appetite would return? It would certainly help the elderly to spend more.

Olaf von Rein

@ReturnFreeRisk: "The myth here is that we need inflation to encourage people to spend." You are missing the point. Deflation rewards the risk-averse rentier. A wealth tax would be more democratic but good luck finding a politician today who will advocate redistribution out of taxation. And so those who believe that aggregate demand would benefit from redistribution must advocate inflation.

@Falmer: "The internet, technology and globalization have vastly improved companies’ ability to meet any growth in demand with minimal investment."

Correct. That's one of the elephants in the room.
Andrew Baldwin: An interesting rebuttal and hopefully the link will remain.

Interest rates are (normally) mainly a function of supply and demand. Rentiers do serve a very useful purpose in the economy and their real return is perhaps higher than a few years ago, or 'less negative'.

José Sopia: points out correctly, it may longer with us and is better getting used to.

Rentiers also contribute to the funds that allow companies to borrow at very low rates to pay out large dividends to global companies while optimizing their tax on profits. Overall the low returns on savings have also lowered the expectations on returns of other assets.

Many Rentiers are sadly the product of a general poor financial education (global phenomena).

José Sopia:

I agree with your analysis, and yes it will endure, in the face of the general prediction every year for the past five years or more now that interest rates have to rise.

The problem with many cautious rentiers, as you put it, is they do not have enough technological skills to add real value to the economy in high-tech investments which is what the advanced economies mostly need in terms of significant growth; they may know something about allocating capital, but there are only so many people like Steven Jobs (of blessed memory). In parallel, do not expect aggregate demand to grow at a significant pace either until average incomes among workers in the countries of early industrialization and those of their counterparts in the newly industrializing countries more or less equalize, a process that could take another 10-30 years.

Yes, this will endure, and yes, get used to it.

Andrew Baldwin:

FT readers may be interested in reading Shaun Richards' outstanding rebuttal, “Savers do serve an economic purpose and why I disagree with Martin Wolf about them” on the mindfulmoney website:


Has FT offered Shaun Richards his own column, I wonder? If not, why not?

DP_of_P:

I hope your conclusion is wrong, Mr. Wolf, else the whole world would be like Japan in a few years.

Instead, real rates should gradually be pulled back at a reasonable level, slightly positive in the short term and with a mild premium in the long, else real investment will keep being distorted with huge sums poured on inefficient, low yielding projects, a chronic oversupply, a Japanified sagging economy begging the neighbor for a few basis points of growth.

dcb:

in light of this post, I hope some will find this pic interesting. Perhaps it helps to explain why there is a lack of demand, and I hope it will actually end any premise of the real reasons we have the policies we do.

I find it rather hard the believe that the “elites” of our society (central bankers, policy markers) couldn't find ways to get the money to the real economy of they wanted to.

http://www.zerohedge.com/sites/default/files/images/user5/imageroot/2014/05/Yellen%20hearing%20slide.jpg

Serf8973521
@MR1501: "Guess those ranting and raving other than the loon zerohedge crowd belong to that category."

Please allow me to highlight that it is the FT 'chief economics commentator' who is championing a 'wipeout' here, not some anonymous fringe blog.

Entertainment worth every penny of an FT subscription.

Burn the seed corn! Burn it all!

ReturnFreeRisk

The myth here is that we need inflation to encourage people to spend. That is a bogus concept propagated by economists who serve wall street and owners of financial assets. Deflation would be good for the economy but not for the holders of stocks and the financial industry.

Paul Munton's Potimarron

@Englishman in Norway

Actually it has not been deleted; you may find it at May 7th 10:29. Now we can all judge if it insulting or not.

Ian Campbell

It is demand side economics that has given us the disastrous recovery since 2008. The cause is not under-whelming aggregate demand (seen house prices recently?) but overwhelming interference in the economy resulting in zero desire for risk taking or the capacity for capital formation. If the dead wood had been cut out once the implosion was prevented then we could have rebuilt from there. The recovery will not happen until a clearly identifiable estimate of reasonable return on investment can be properly forecast by both savers and entrepreneurs.

As it is, with interest rates on zero, assets are overvalued, cash earns nothing so incentives to work to save are minimal with the consequence that innovation is deferred at best. Demand management means someone else deciding how to spend your money who will also borrow more from your and your children's future: that they know better than you. It is a fundamentally bankrupt philosophy that has been tried before and failed, again and again, other than in minor doses for short term down turns.

We are in a much more problematic era than that and real solutions should be sprouting from these pages not tired old Keynesian economists (Keynes would be spinning in his grave at the thought he was the inspiration for such stupidity) who have never learnt what works in practice rather than in a classroom.

Falmer

Mr. Wolf should address the increase in the productivity of investment, making it much cheaper to raise production without much capital. The internet, technology and globalization have vastly improved companies' ability to meet any growth in demand with minimal investment.

Paul Munton's Potimarron

@Englishman in Norway

I noticed your comment; I thought it insulting to the writer.

Englishman in Norway

Well, I put in a comment earlier today castigating Mr Wolf for his misplaced idea that printing money can replace actual savings, it was deleted. It's very sad that whenever someone has a different opinion than that of the MSM, they are deleted, will I be deleted this time??
Wipe out rentiers with cheap money - FT.com

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